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## The European Legal Expenses Insurance Market

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# **The European legal expenses insurance market**

## **new strategies: the litigation buyout policy<sup>1</sup>**

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**Abstract:** The paper develops some preliminary considerations about the European legal expenses insurance market and, in the light of the emerging EU collective litigation, it introduces the case of the litigation buyout insurance, a policy that has been adopted under certain circumstances by corporate defendants and their insurers to afford the coverage for current or prospective mass litigation in the United States

**Key Words:** Legal expenses insurance - Collective redress - Litigation buyout policy

**Summary:** 1. Setting the scene - 2. Before The Event Legal Expenses Insurance (“BTE”) - 3. After The Event Legal Expenses Insurance (“ATE”) - 4. Collective redress in the European Union - 5. The position of the legal protection insurers - 6. Litigation Buyout Policy - 7. Legal insurance in the light of the Eschig case

### **1. Setting the scene**

According to a leading expert in the field: “[t]he risk covered by LEI (i.e. legal expenses insurance) is the need to receive assistance in a dispute. Contracts will flesh out this broad definition, specifying the nature of the assistance (e.g. information, advice, assistance in the strict sense, in or out of court) and the type of dispute to which the cover relates in particular circumstances”<sup>1</sup>.

It is difficult to indicate a date for the beginning of modern legal expense insurance (W Pfennigstorf 1975 at 453).

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<sup>1</sup> Paper presented at the 13th Joint Seminar of the European Association of Law and Economics and The Geneva Association, *Insuring Corporate Liability Risks*, May 11-12, 2009, Angelo Sraffa Department of Law, Università Bocconi, via Röntgen 1, Milano

Since the business was long limited to matters related to automobile ownership and automobile traffic, and in some countries still is, the industry is often said to have originated in 1917 when the first specialized automobile owners' legal defense company was organized in France (W Pfennigstorf 1975 at 455).

The boom of automobile tourism after World War II produced an increase in the demand for LEI: the economic upturn in Europe after the war was, as is well known, rapid. Motor cars, which had been nothing more than a plaything for the affluent since the 30s, became everyone's tool and a popular symbol of unexpected wellbeing which all aspired to possess. Consequently, the number of road accidents increased considerably, the third party motor insurance became compulsory in many countries and LEI started to expand its scope and goals.

In 1958 lawyers were invited to a congress by their two most important world organisations, the International Bar Association (I.B.A.) and the Union Internationale des Avocats (U.I.A.). In both cases the "LEI issue" was considered with the same suggestions: the insurers' contribution should be restricted to the financial aspect only, that is payment for the loss and lawyers' fees, the latter freely chosen and appointed by the insured without any interference by the insurer in the handling of the dispute <sup>2</sup>.

In the early '60s the Commission had just ventured into the European insurance labyrinth to launch the first directives to coordinate regulations in the insurance field. One of the first problems facing it was the desirability of separating life and nonlife branches according to the formula already in use in France, Germany and Holland, where the intention was to prevent poor performance of a company in the loss business prejudicing the interests of insured parties holding life policies with the same company - socially considered to more properly merit protection <sup>3</sup>.

At that time and in the early '70s, in most European countries - with the significant exceptions of Germany and some adjacent states - LEI was

something mysterious: its nature and purpose were still obscured by some theoretical and practical legal uncertainties and confusions.

Only at the end of the '80s the Commission has regulated such policy by adopting the European Directive 87/344 ("LEI Directive")<sup>4</sup> that provides for a definition and clarifies that the insurer undertakes, against the payment of a premium, to bear the costs of legal proceedings, to provide other services directly linked to insurance cover (in particular with a view to secure compensation for the loss, damage or injury suffered by the insured person by settlement out of court or through civil or criminal proceedings) and to defend or represent the insured person in civil, criminal, administrative or other proceedings or in respect of any claim made against him (point 2).

It aims primarily to neutralize any potential conflict of interest between insured and insurer: any conflict of interest arising, in particular, from the fact that the insurance company is covering another person or is covering a person in respect of both legal expenses and any other class of insurance should be precluded or resolved. In this perspective, the specific conflicts between the LEI insurer and the insured persons on the issue of merit should be settled efficiently: thus, LEI Directive requires the Member States to adopt all appropriate measures to ensure that, in the event of a difference of opinion between a legal expenses insurer and his insured, a decision can be taken on the attitude to be adopted in order to settle the dispute (without prejudice to any right of appeal to a judicial body which might be provided for by national law, an arbitration or other procedure offering comparable guarantees of objectivity is provided for whereby) (Article 6).

At this regard, I underline that the Code of Practice of the International Association of LEI insurers ("RIAD") - adopted in 1993 - also states that the legal expenses insurer shall carry out its activity *for the benefit of the policyholder* and *shall assume the defence of the rights and legitimate interest of the latter*, as though it were a matter concerning its own interests.

In 2005 the European Parliament had proposed to include legal expenses as part of the Fifth Motor Insurance Directive<sup>5</sup>, but the Commission's consultation indicated that in the majority of the Member States voluntary legal expenses insurance is provided by specialized insurers or insurance companies and England, Germany, Belgium and Sweden held that a relatively large proportion of their population have access to such insurance. Thus, the latest Motor Insurance Directive has done little either to alter the nature of the LEI market, nor has it provided any impetus for growth.

## **2. Before The Event Legal Expenses Insurance (“BTE”)**

Before the Event (“BTE”) insurance, also known as “BTE insurance”, is an insurance policy which can be taken out by those wishing to protect themselves against the potential litigation costs, which could be incurred following a future event. These costs often include solicitors' fees, barristers, expert witnesses, court fees and any legal costs awarded to the other side. BTE insurance is generally paid on an annual basis to an insurance company and it is often sold as part of a household or car insurance package and sometimes offered as a benefit to members of a trade union or association (V Prais 1995).

The role and relevance of BTE insurance varies among European countries. The penetration rate of general household BTE insurance in Germany is some 50 %, by contrast, in England and Wales the demand for this type of insurance policy seems to be virtually absent. In other markets there is a trend towards multiple markets for BTE in which both middle-class households and SMEs display an increasing demand for BTE products (A Heyes, N Rickman and D Tzavarab 2004).

A research by the UK Ministry of Justice in October 2007 found that despite 59% of the population having legal expenses insurance, less than one in four consumers had ever heard of BTE or ATE legal expenses insurance and consequently the holders of certain policies (e.g., household insurance) may

not even be aware that their insurance also covers certain legal expenses. The research estimated that 28 millions of adults have BTE insurance, mostly as an add-on to another insurance policy. The research also shows that LEI is sold in a variety of ways (stand-alone, add-on) and through multiple channels and that the cover provided by add-on LEI is fragmented and sometimes duplicated <sup>6</sup>.

I agree with the idea that whether and how the BTE market in Europe will develop depends on domestic institutional factors, such as the extent of tax-funded legal aid and the intensity of regulation of legal services. Accordingly, an author notes that “(...) one would expect a BTE market not to flourish in a country with comprehensive state-funded legal aid. And indeed, England and Wales spend a lot of taxpayers’ money on legal aid, while German consumers spend less on taxation for legal aid but all the more on private BTE LEI” (Van Boom 2009 at 5).

One of the institutional settings that seem to be relevant in explaining differences in development of BTE markets pertains to the rules on cost shifting in civil procedure: it is more likely to thrive under cost regimes that generate a certain level of predictability so that the German costs rules (the loser pays according to fixed scales) are more beneficial to BTE insurers looking for predictability than the current English cost shifting rules.

More important, BTE insurers have every incentive to fix and control lawyers’ remuneration and possibly even to employ in-house lawyers in order to accurately calculate (and cut) premiums. Again, the institutional environment in which BTE providers operate influences the interaction between insurers and independent providers of services on the market for legal services to a large extent. BTE insurers have an obvious interest in keeping the cost of litigation low: this may not be easily achieved in markets in which lawyers have a statutory monopoly on giving legal advice, as is the case in Germany, while, in countries where there is no such monopoly they have every opportunity to develop their own in-house legal expertise by vertically integrating lawyers into their business. By doing so, they can

achieve economies of scale and curtail agency problems inherent with outsourced legal services and, at the same time, they can contribute to improve the access to justice (M Kilian 2003).

### **3. After The Event Legal Expenses Insurance (“ATE”)**

After the Event insurance, also known as “ATE insurance”, can be taken out after an event, such as an accident which has caused an injury, to insure the policyholder for disbursements, as well as any costs should they lose their case.

Such policy is thus entered into by the claimant (or his lawyer operating under some form of “conditional fee agreement”, in short: “CFA”) after the dispute has already arisen (G Wignall and S Green 2008).

Two distinct versions of ATE insurance are currently available in Europe: ATE third party funding and ‘English ATE’ as an add-on insurance with CFA (W H Van Boom 2009, at 9-10).

First, ATE third party funding entails the following: i) the ATE provider will typically offer to finance all costs involved in a money claim, against a ‘premium’ which is due only in case of success, ii) the provider diligently investigates the creditworthiness of the defendant and the viability of the claim (with the help of legal opinion of the lawyer who analyzes the case), iii) if the claim is found valid, ATE will provide the upfront funding required, the success premium is both contingent on the disputed amount and staged .

The benefits of this type of ATE to impecunious and/or risk averse (commercial) claimants are self-evident, and in those jurisdictions that restrain lawyers admitted to the bar from charging their clients on any other basis than a (fixed) hourly fee the ATE insurance has the potential of becoming a competitive product. It seems likely, moreover, that restrained

lawyers would be tempted to associate themselves somehow with ATE providers: in the near future legal systems will be faced with the question whether lawyers would be allowed to accept commission for clients they refer to the provider (N Rickman & A Gray 1995).

Second, the 'English ATE insurance' is different from the ATE funding before mentioned given that the specific conditions of English costs rules allow for a specific CFA plus ATE insurance agreement. In particular, for certain types of claims solicitors are permitted to offer their services under a CFA that denotes a combination of no-cure-no-pay and a success fee, a mark-up success fee, either in the form of a flat fee or an upscale fee expressed as percentage of basic hourly fee, but not contingent on the amount of the sum successfully recovered (R CA White & R Atkinson 2000).

Under the CFA, if the claimant is defeated in court his solicitor will not claim any remuneration. There is, however, still the issue of the prevailing defendant's costs. English costs rules allow the claimant to take out ATE insurance covering these costs: if the claimant wins the case, he is allowed to shift the costs of both his lawyer's fee and the ATE insurance premium onto the defendant. The defendant does not experience any specific financial consequences if he prevails. If he loses, however, he is forced to reimburse the claimant for the ATE insurance premium.

Thus, the losing opponent has to pay for the risk aversion of the winning party (G Wignall and S Green 2008).

The Court of Appeal ruling in *Rogers v Merthyr Tydfil v. Be* has brought some certainty over some aspects of recovering ATE premiums from losing defendants<sup>7</sup>. The court ruled that the proportionality of the premium should relate to the costs risk, rather than the damages and also approved the principle of premiums that are staged, meaning they go up at certain points of a case as it becomes more risky<sup>8</sup>.

### **3. Collective redress in the European Union**



The market for LEI changes rapidly in accordance with the developments of the European litigation landscape. In particular, European companies and their insurers are beginning to see collective claims on the legal horizon and becoming concerned about the solutions they can take to limit the corporate liability risks arising from collective litigation (S Issacharoff and G Miller 2008).

And actually a Report by Lloyd's and Rand Europe indicates three fast moving trends in litigation which are becoming influential on both sides of the Atlantic: third party litigation funding, forum shopping and class actions<sup>9</sup>. With reference to the latter, the Report notes that the US has seen a substantial growth rate in class actions, although this rate now seems to be slowing, after the Class Action Fairness Act has entered into force<sup>10</sup>. It also underlines that some US class action firms are establishing a presence in England and a relevant part of the litigators believe that class actions will take root in the country within three years.

At this stage, the picture is not clear, but developments are emerging in the civil procedure rules of some Member States and in European Law.

The experiments about collective litigation in the Member States may be grouped into three main categories: (a) group actions, where individual actions are grouped into one procedure (Italy, Portugal, Spain, Sweden), (b) representative actions, where one individual or an organization represents a group of individuals (Italy, Spain and France and (c) test cases, where a case brought by one or more persons leads to a judgment that forms the basis for other cases brought by persons with the same interest against the same defendant (England and Wales, Austria, Germany) (D Hensler, C Hodges and M Tulibacka 2009, Hodges 2008, R Mulheron, 2004).

In 2005 the Commission has issued the Green Paper "Damages actions for breach of the EC antitrust rules", stating the necessity to introduce one or more mechanisms allowing the aggregation of the individual claims of victims of antitrust infringements: consumers, especially those who have

suffered a relatively low-value damage, are often deterred from bringing an individual action for damages due to the costs, the delays, the uncertainties and the burdens involved<sup>11</sup>. Thus, the Commission suggests a combination of two complementary mechanisms of collective redress to address effectively those issues in the field of Competition Law<sup>12</sup>.

A further step has been the adoption in 2008 of the White Paper suggesting some specific policy choices and measures that would help give all victims of infringements of EC Competition Law access to effective redress mechanisms so that they can be fully compensated for the harm they suffered<sup>13</sup>.

Few months later, the Directorate General on Consumer Affairs has adopted the Green Paper ‘On Consumer Collective Redress’ (“Green Paper”)<sup>14</sup>.

Before the adoption of the Green Paper, a study by external contractors has provided the Commission with more information on the key problems faced by European consumers in obtaining redress for mass claims and has analyzed the consequences of such problems for consumers, competitors and the relevant market<sup>15</sup>.

In the light of the above, in the Green Paper on Consumer Collective Redress the Commission has reached the conclusion that:

“the vast majority of the existing collective redress mechanisms tend to have some elements that work, and some that do not. Almost all existing collective redress mechanisms have some added value compared to individual judicial redress and alternative dispute resolution schemes. But their efficiency and effectiveness could be improved. The mechanisms have been applied in relatively few cases” (at point 12).

In consideration of the confusing diversity of national approaches towards collective redress, many of which are relatively recent, the Commission faced considerable difficulty in identifying any given approach as a preferred solution (C Poncibò 2009).

The Green Paper effectively side-steps this selection issue, by setting out a number of alternative options, without making a decision. In an important

change from many previous discussions on this issue, the options set out include not just judicial, court-based private litigation, but also encompass the involvement of public authorities in delivering redress and compensation, as well as the encouragement of voluntary and self-regulatory mechanisms (“ADR”).

Leaving aside the possibility to avoid any European initiative, two main perspectives, that can also be combined, have emerged in such context.

The first consists in improving the cooperation between the Member States and, particularly, in utilising the existing national collective redress procedures, while opening them up to consumers from other Member States. This approach provides for the implementation of a network of entities that have the power to bring a collective redress action in those Member States having such mechanisms, including public bodies and consumer organisations, coupled with launching information campaigns about pending collective redress actions and enabling people to join them (e.g. the Consumer Protection Cooperation Regulation <sup>16</sup>).

The network would need to involve an equitable mechanism for bearing the costs of proceedings (and distribution of money) to national and foreign consumers entitled, given that national entities might be reluctant to pay for foreign claimants <sup>17</sup>.

The second and much discussed option would be to adopt a non-binding, or binding, EU measure to ensure that a collective judicial mechanism exists in all Member States.

This idea leaves from the fact that existing European instruments have a limited application to mass claims: the Mediation Directive, that has to be implemented by 2011, can only help in cases where the parties are willing to mediate <sup>18</sup>, while the Small Claims Regulation concerns cross-border disputes not exceeding a certain amount (i.e. 2.000 Euro) and whether it applies to collective redress will depend on national procedural rules <sup>19</sup>.

The Follow-up of the result of the Consultation on the Green Paper showed that no single option is fully satisfactory that only a combination of several instruments would be the most appropriate way forward<sup>20</sup>.

#### **4. The position of the legal protection insurers**

According to the comments of the International Association of LEI insurers (“RIAD”), the Commission’s approach is too confined and it does not determine its general policy objectives correctly when it establishes that it wants to ensure access to effective means of redress for consumer mass claims across the European Union<sup>21</sup>.

Legal protection insurers agree with the Commission that consumer confidence is important for the Internal Market and that confidence is created to a large extent by providing efficient means to pursue and defend legitimate interests and claims. But their association (“RIAD”) stresses that the Commission still does not succeed in convincing legal protection insurers that, above all, the lack of a legal framework for an EU-wide collective redress instrument actually distorts the Internal Market and that the absence of this particular instrument is responsible for the lack of consumer confidence. The problem is much broader and a more horizontal approach is necessary in order to embrace all possible implications, answers and remedies.

Consequently, the general policy objective must rather be to facilitate easy, affordable and efficient access to law and justice across the EU in general without simply insinuating that access to mass claims is the only viable instrument and solution. In this context, LEI could be an important and affordable feature for consumers to enforce their rights efficiently.

More important, the legal protection insurers and their association have also stressed the importance of enhancing cooperation and compatibility between the different national systems and mechanisms before creating an additional European instrument which can hardly solve any of the existing consumer detriments.

In such a perspective, they have rejected the idea of a EU-wide judicial collective redress mechanism of the consultation paper and have proposed to adopt a non-binding setting up of collective ADR schemes and judicial collective redress schemes) in combination with the adaptation of some other EU instruments would be likely to hold the best prospects.

The approach of RIAD is in line with the proposal of the Green Paper on the review of the Brussels I Regulation to provide procedural means which facilitate the coordination of parallel proceedings before the courts of different Member States in order to avoid the risk of irreconcilable judgments resulting from separate proceedings<sup>22</sup>.

## **5. The litigation buyout insurance**

In the United States the “litigation buyout policy” (“LBP”) has been adopted, under certain circumstances, to address the risks posed to corporate defendants by class actions and, more generally, mass tort litigation (T Baker and S J Griffith 2007).

It is thus interesting to consider such policy that enables the insured to remove all, or part, of its risk in connection with an unresolved claim or claims or litigation by transferring future potential liabilities arising there from to the insurer.

Such policy can either completely remove the contingent liability from the books of the insured or, at least, cap future financial risks associated with the litigation. It can be structured to cover defence costs, settlements, judgments and defence costs or judgments only and it have been use in

cases involving products liability, environmental and asbestos, intellectual property and tax.

Unlike traditional insurance products, such policy covers events that have already occurred or are known to the insurer when the policy is purchased (however, the amount of the total exposure remains uncertain).

LBP has evolved to provide an insured with a customised strategy to manage and resolve a wide array of negative events, such as securities litigation, intellectual property claims, product liability, breach of contract disputes, employment practices claims. LBP has proven to be an effective tool in facilitating transactions when the parties cannot agree on the exposure arising from the litigation or the risk allocation associated with the litigation. The case is analyzed by risk managers to determine the most likely worst-case scenario, then tack on about 20 % to represent a margin of error, and another 15 % or so for expenses and profit.

Projecting the size of a lawsuit requires a painstaking analysis implying to consider the case-law on that topic and to examine how those suits turned out and how successful they have been in that jurisdiction with similar litigation in the past (T Baker and S J Griffith 2007).

Going into details, such policy usually falls within two categories: loss portfolio transfers and appeal hedges.

Loss portfolio transfers, also known as buyouts, involve the insurer stepping into the shoes of the insured and taking over a pending litigation and ensuing liability. In exchange for assuming the potential liability arising from a litigation, the insurer will charge a premium based upon its expectations as to the settlement value or the judicial damages, plus underwriting costs and defence expenses. The most used version of the buyout is the liability cap: the liability cap acts as a stop loss for pending litigation, where the insured remains liable for a specified amount of damages, while the insurer assumes liability for the next layer of exposure. This coverage may be illustrated by the following example: a company is a defendant in a large product liability litigation. The company seeks to be

acquired by a buyer in an M&A transaction, which becomes stalled due to the ongoing litigation.

An LBP policy would insure the company against liability arising out of the pending product liability litigation not covered by its primary insurance carrier and would enable it to proceed with its M&A opportunity<sup>23</sup>.

This scheme comes from the “Samsonite Case”. The company was struggling with some heavy baggage as it attempted to recapitalize a couple of years ago. The cause of the load: shareholder litigation, filed in the wake of the stock-price free fall from a failed attempt to sell the company. The suits hampered the Denver-based manufacturer’s recapitalization efforts--and threatened consequences even more dire. The company managed to remove its litigation burden, but not in any of the usual ways. By transferring the risk to an insurance company, Samsonite eased the worries of the investors it was courting. In addition to removing an impediment to consummating a transaction, several other benefits may accrue to an insured that purchases LBP coverage: i) it enables an insured to quantify the future value of liabilities resulting from third-party claims in order to manage them more effectively and, under certain circumstances, ii) it permits a public disclosure of an insurance solution for an ongoing litigation exposure, thereby sending a positive signal to the market and iii) it also consents to the insured to focus its management time on running the business, rather than handling a time-consuming litigation. Moreover, appeal hedges serve as hedges against reversal on appeal of a favourable judgement, locking in the positive ruling’s benefits to the insured.

In a buyout policy, the insurer will generally require complete control of the conduct of the litigation given that it assumes the entire risk and, generally, also covers all defense costs in connection therewith. In a cap or a hedge, where an insurer only assumes part of the risk or where the proceedings are already at an advanced stage, an insurer will want to maintain control over major strategic decisions, such as choice of counsel or right to settle. Although insureds usually cede those prerogatives only reluctantly, they

usually benefit from an insurer's expertise in claims management and litigation. The control over litigation may therefore create problems when a claim is made against an insured, the insured and the insurer may disagree about the best way to resolve the claim. For instance, a settlement opportunity presents itself and the insurer wants to settle the claim but the insured does not. Or, there may be a judgment against the insured, which the insurer is willing to accept as final resolution of the claim, but the insured is not and instead wants to appeal the matter further. Perhaps the insured believes their business will ultimately be exonerated of any wrongdoing and would rather litigate to reach that point. Or, the insured doesn't want to settle because they believe there is further room to negotiate for a more favorable resolution.

Most LBP policies contain a "hammer clause" which allows the insurer to resolve these differences of opinion. The clause is usually found in the section of the policy that discusses settlement and whether the insurer has the right to settle or must obtain the insured's consent before doing so.

The majority of hammer clauses allow the insurer to cap or limit their ultimate exposure in a particular claim. For example, some policies say that if the insured does not agree to settle a claim the insurer wants to settle, the insurer's exposure is capped at the amount they would pay to resolve the claim, plus a percentage of the future costs incurred in resolving the claim (including defense and indemnity). Disclosure of the existence of coverage is also a delicate issue. The amount of coverage under this kind of policy is based on the potential liability arising from the lawsuit and maximum coverage is typically tied to damages sought in the lawsuit. As a rule of thumb, higher premiums will be charged by the insurance company for assuming increased exposure. Insurers usually impose confidentiality restrictions under the assumption that the outcome of the litigation may be adversely impacted if a court or claimant comes to know that a 'deep pocket' insurer agreed to assume the liability. From an insured's perspective, however, the ability to disclose such coverage may be a priority



- a press release announcing that a major contingent liability has been removed from a company's balance sheet sends a very positive message to the market (T Baker and S J Griffith 2007).

## **6. Legal insurance in the light of the Eschig case**

The “free choice of the lawyer” by the insured person or company is, granted by the Article 4 (1) of the LEI Directive, providing that:

“Any contract of legal expenses insurance shall expressly recognize that:

(a) where recourse is had to a lawyer or other person appropriately qualified according to national law in order to defend, represent or serve the interests of the insured person in any inquiry or proceedings, that insured person shall be free to choose such lawyer or other person;

(b) the insured person shall be free to choose a lawyer or, if he so prefers and to the extent that national law so permits, any other appropriately qualified person, to serve his interests whenever a conflict of interests arises”.

The free choice of the lawyer is restricted in instances when legal representation by a lawyer before an official court is compulsory by law (attorney, barrister, solicitor or whatever the official title of this representative may be).

Within the framework of the legal expenses insurances and, particularly, the litigation buyout policies (as better illustrated in the previous paragraph), the insured person or company may have to give up some, if not all, control over the defence of the case in favor of the insurance company.

It is not uncommon for a policy to stipulate: “We will choose an appointed representative to act for you. If you are not satisfied with the appointed representative we have chosen, you can choose another appointed representative” and “We may choose not to accept an appointed representative of your choice but this will only be in exceptional circumstances” (Van Boom 2009 at 7). Thus, by shaping the BTE LEI

contract, the insurer remains in control of the choice of lawyer and minimizes control of the insured over the policy.

Evidently, the interests of the LEI insurer do not necessarily converge with the interests of the policyholder with regard to both merits and free choice of counsel. As article 4 does not specifically oblige insurers to actively disclose the right of free choice of counsel to the policyholder, these rights are more or less obscured in the small print (Van Boom 2009).

Moreover, even if insurers were to actively disclose this right to the policyholder in the claims process, there would still be the matter of merit. The Directive does not restrain the insurer from assessing merit before allowing the policyholder to litigate.

In the light of the above it is clear that the ideal of ‘free choice of lawyer’ does not fit easily within the business model of some LEI providers.

The European Court of Justice (“ECJ”) has recently ruled that the Austrian legal expenses insurers practice of selecting the lawyers to represent their clients in collective redress proceedings *is an inadmissible limitation of the rights of the insured*.

The case (“Eschig”) concerns the so-called, “mass claims clause” used by Austrian legal protection insurers<sup>24</sup>.

In Austria, as in other European countries, legal protection insurers seek to combine the legal representation of their clients’ interests: the “mass claims clause allows” insurers to select the legal team when several insured parties in similar situations wish to pursue claims against the same opposing party<sup>25</sup>. In *Eschig* the referring court asked, in essence, whether the before quoted Article 4(1) (a) of the LEI Directive is to be interpreted as entitling the legal expenses insurer to reserve the right, where a large number of insured persons suffer losses as a result of the same event, itself to select the legal representative of all the insured persons concerned.

On the contrary, the insurance industry has stated that, by selecting specialised lawyers, it is possible to optimise the professional competence to

best defend the clients' interest and has expressed concerns on the "strict" interpretation given by the ECJ of the LEI Directive.

According to the Advocate-General Verica Trstenjak the position of Article 4(1)(a) within the overall structure of LEI Directive and the aims of the directive indicate that the right to a legal representative of one's choice in proceedings and inquiries is intended to be an independent right and that, in the light of the above, the article 4 (1) (a) also applies in mass tort cases<sup>26</sup>.

Following the reasoning of the Advocate-General, the ECJ has ruled that the Austrian legal expenses insurers practice of selecting the lawyers to represent their clients in mass tort cases is an inadmissible limitation of the rights of the insured under the LEI Directive.

From a legal point of view the ruling is consistent with the LEI Directive, grounding on the principle that every citizen should be free to choose his/her legal counsel, and which makes no exemption from the free choice of lawyer in respect of collective actions. However, it is also true that the 'mass claims clause' may also be in the interest of individuals, who all have a common cause of action and for who the use of a single legal team may have the effect of improving the management of their legal action.

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## Notes

<sup>1</sup> For an historical perspective see the article of Carlo Isola (Secretary General RIAD 1972-1993) 'Legal expenses insurance: origins and development', International Association of Legal Expenses Insurance ('RIAD'), pp. 1-20. Accessed 22 March 2010 at <http://www.riad-online.net/68.0.html>

<sup>2</sup> Before at 10.

<sup>3</sup> Before at 11.

<sup>4</sup> Council Directive 87/344/EEC of 22 June 1987 on the coordination of laws, regulations and administrative provisions relating to legal expenses insurance, OJ L 185 4 July 1987, pp. 77-80.

<sup>5</sup> Directive 2005/14/EC of the European Parliament and of the Council of 11 May 2005 amending Council Directives 72/166/EEC, 84/5/EEC, 88/357/EEC and 90/232/EEC and Directive 2000/26/EC of the European Parliament and of the Council relating to insurance against civil liability in respect of the use of motor vehicles, OJ L 149, 11 June 2005, pp. 14 - 21.

<sup>6</sup> FWD Research, 'Report The Market for 'BTE' Legal Expenses Insurance', prepared on behalf of the Ministry of Justice July 2007. Accessed on 10 March 2010 at <http://www.justice.gov.uk/publications/docs/market-bte-legal-expenses-insurance.pdf>

<sup>7</sup> *Rogers v. Merth'yr Tydfil v. Be* [2006] J EWCA Civ 1134.

<sup>8</sup> N. Rose, After burners, in *The Legal executive journal*, November 2008, pp. 20-24.

<sup>9</sup> Lloyds Report 'Litigation and business: Transatlantic Trends', 25 November 2008.

<sup>10</sup> U.S. Class Action Fairness Act of 2005, 28 U.S.C. Sections 1332(d), 1453, and 1711-1715. The Act gives federal courts jurisdiction to certain class actions in which the amount in controversy exceeds \$5 million, and in which any of the members of a class of claimants is a citizen of a state different from any defendant, unless at least two-thirds or more of the members of all proposed plaintiff classes in the aggregate and the primary defendants are citizens of the state in which the action was originally filed. The Act also directs the Courts to give greater scrutiny to class action settlements, especially those involving coupons.

<sup>11</sup> European Commission, 'Green Paper 'Damages actions for breach of the EC antitrust rules'', 19 December 2005, COM (2005) 672.

<sup>12</sup> A representative action for damages brought by entities with certain characteristics - such as consumer organizations, trade associations and State bodies - on behalf of identified, or, in rather restricted cases, identifiable victims (not necessarily their members); and an opt-in collective action where the claims from individuals or businesses are combined in one single action. In such model of action, as opposed to representative actions as defined above, the claimant himself has suffered harm. According to the Green Paper, these two actions will complement each other for two main reasons: first, the qualified entities will not be able or willing to pursue every claim; second, it is important that consumers are not deprived of their right to bring an individual action for damages if they so wish.

<sup>13</sup> European Commission, 'White Paper on Damages actions for breach of the EC antitrust rules', COM (165) 2 April 2008, at 4, and 'Staff Working Paper accompanying the Green Paper on Damages actions for breach of the EC antitrust rules', SEC (404), 2 April 2008.

<sup>14</sup> European Commission, 'Green Paper 'On Consumer Collective Redress'', 27 November 2008 COM (2008) 794.

<sup>15</sup> Civic Consulting of the Consumer Policy Evaluation Consortium ("CPEC"), 'Study regarding the problems faced by consumers in obtaining redress for infringements of consumer protection legislation, and the economic consequences of such problems', 28 August 2008. Accessed 22 March 2010 at [http://ec.europa.eu/consumers/redress\\_cons/finalreport-problemstudypart1-final.pdf](http://ec.europa.eu/consumers/redress_cons/finalreport-problemstudypart1-final.pdf)

<sup>16</sup> Regulation No. 2006/2004 of the European Parliament and of the Council of 27 October 2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws, in OJ L 364 9 December 2004, pp. 1-11.

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<sup>17</sup> Green Paper on the Review of the Council Regulation (EC) No. 44/2001 on jurisdiction and enforcement of judgments in civil and commercial matters, 21 April 2009, COM (2009) 175 fin.

Report from the Commission to the EU Parliament, the Council and the European Economic and Social Committee on the application of Council Regulation (EC) No 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, 21 April 2009, COM/2009/0174 fin.

<sup>18</sup> Council Directive 2008/52 of the European Parliament and of the Council of 21 May 2008 on certain aspects of mediation in civil and commercial matters, in OJ L 136, 24 May 2008, pp. 3-8.

<sup>19</sup> Regulation No 861/2007 of the European Parliament and of the Council of 11 July 2007 establishing a European small claims procedure, in OJ L 199, 31 July 2007, pp. 1-22.

<sup>20</sup> European Commission, 'Consultation paper for discussion on the follow-up to the Green Paper on Consumer Collective Redress' and the responses of the stakeholders (2009). Accessed 26 March 2010 at [http://ec.europa.eu/consumers/redress\\_cons/collective\\_redress\\_en.htm](http://ec.europa.eu/consumers/redress_cons/collective_redress_en.htm)

<sup>21</sup> International Association of Legal Expenses Insurance ('RIAD'), Response to the Consultation on the Green Paper on Consumer Collective Redress, 27 February 2009. Accessed on 30 March 2010 at [http://ec.europa.eu/consumers/redress\\_cons/response\\_GP\\_collective\\_redress\\_en.htm](http://ec.europa.eu/consumers/redress_cons/response_GP_collective_redress_en.htm)

<sup>22</sup> Note 17.

<sup>23</sup> LBP falls within the scope of the so-called 'transactional insurance products', a set of tools offered by insurers to facilitate the closing of mergers and acquisition and finance transactions where the parties require additional comfort on a variety of issues (e.g. representations and warranties insurance in a M&A transaction).

<sup>24</sup> ECJ, Judgment on 10 September 2009, Case C-199/08, *Erhard Eschig v. UNIQA Sachversicherung AG.*, in OJ C 267 7 November 2009, p.19.

<sup>25</sup> In the case here cited the ECJ has examined the article 6.7.3 of the Allgemeine Bedingungen für die Rechtsschutz Versicherung 1995 (general conditions applicable to legal expenses insurance) providing that: 'Where several insured persons enjoy insurance cover under one or more contracts of insurance in order to assert their legal interests and where their interests are directed against the same opposing party or parties, on the basis of the same or a similar cause, the insurer is entitled initially, in the performance of its contractual bargain, merely to assert the legal interests of the insured persons extrajudicially and to have test cases brought as necessary by legal representatives selected by it'.

<sup>26</sup> Opinion of the Advocate General Trstenjak of 14 May 2009, in Case C-199/08, *Erhard Eschig v. UNIQA Sachversicherung AG.*, in OJ C 267 of 7 November 2009, p.19.